

Alaska Permanent Fund

REPORT TO ALASKANS

A public trust investing for Alaska's future.

Fiscal year 2002 was a tough year for investors, but the Alaska Permanent Fund weathered it better than most. Despite double-digit negative returns from the U.S. stock market, the well-diversified Fund managed to moderate its losses by earning significant positive returns in bonds and real estate and ended the year down only 2.2 percent, thus out-performing both its benchmark (-3.7 percent) and the average public pension fund (-5.2 percent).

Investing for generations

For the 20th consecutive year, Fund principal was fully inflation-protected in 2002, its long-term purchasing power kept whole so that the Fund can continue to provide real benefits to future generations. For the benefit of the current generation, the Fund was able to provide sufficient income to fully pay the 2002 Permanent Fund dividends – thanks to a large earnings reserve account built up and retained during the good years.

The earnings reserve, which acts as a cushion against poor financial markets, ended the fiscal year with a June 30 balance, after accounting for dividends and inflation-proofing, of \$1.6

billion. Two years ago, this account totaled \$6.5 billion.

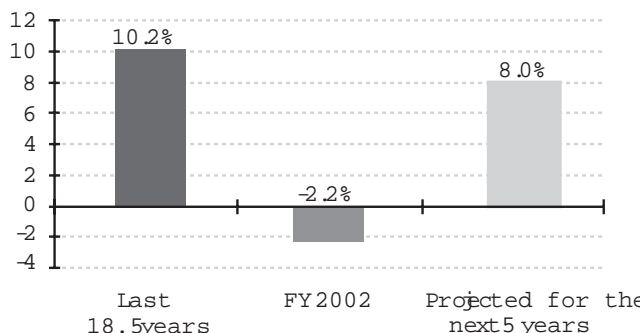
What caused the \$4.9 billion decline in the earnings reserve? About one-quarter of it (\$1.3 billion) was transferred to principal for inflation-proofing over the last two years. That money remains in the Fund, ensuring its long-term purchasing power. Another 40 percent of it has gone to dividends (\$2 billion combined for 2001 and 2002). The rest, approximately one-third (\$1.6 billion) reflects the depreciation in the market value of the Fund's investment portfolios, primarily stocks.

Corporate governance

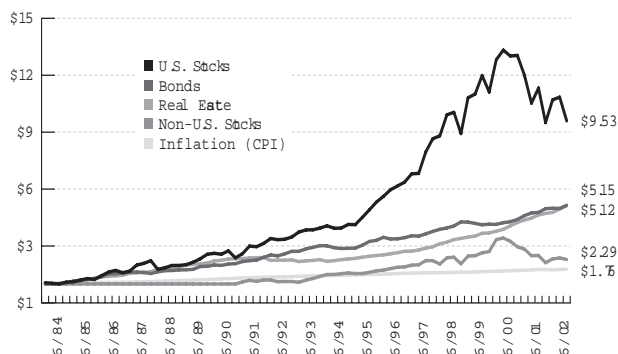
The rash of accounting scandals in corporate America was another source of difficulty in fiscal 2002, particularly in June when, coupled with poor economic news, the Fund's performance actually turned from positive to negative after recovering from losses earlier in the year.

To fully protect the interests of Alaska shareholders, the Board has become increasingly engaged in corporate governance.

Permanent Fund total return
Annualized for the past, present and future



Permanent Fund cumulative returns by asset class
Growth of \$1 over the past 18.5 years



The increased involvement began last year with Board educational sessions on proxy voting practices in April 2001; fiduciary responsibilities in May 2001; class action litigation in February 2002; and external manager conflict of interest policies in March 2002.

The Board has also taken a number of actions: in November 2001, we established a Corporate Governance Committee chaired by the Attorney General; in February of this year, the Fund joined the Council of Institutional Investors, a shareholders' rights organization comprised of public, private and union pension plan sponsors; and in March and June, the Board adopted new policies on proxy voting and class action litigation.

The Board will continue to be active on corporate governance issues and we will do our best to hold the companies in which the Fund invests to high standards of accountability.

Support for complete and protected inflation-proofing

The Board and the staff were also engaged during the year in public policy debates. The Board recommended an important amendment to the state constitution which, while it has not yet been adopted by the legislature, has been widely discussed and supported by prominent Alaskans and newspaper editorial boards. This proposed constitutional amendment will again be proposed in 2003 as an essential part of any long-range fiscal plan for the State of Alaska.

For more information on this issue, please read The Trustees' Papers, Volume VII: Making the case for complete and protected inflation-proofing, which is available on the APFC web site at www.apfc.org.

Staying the course

While periodic market corrections are inevitable – and frequently healthy over the long term – they can challenge even the most focused, long-term investor. The Board's asset allocation policy balances the risks of negative returns in the short term against the rewards of higher positive returns over the long term.

For a patient investor with good diversification like the Alaska Permanent Fund – which as of June 30, 2002, held 34 percent of its assets in U.S. stocks, 16 percent in non-U.S. stocks, 11 percent in real estate and 39 percent in fixed income – risk is diminished over time. Although there is a one-in-four chance that the total Permanent Fund will earn a negative return in any single year, there is only a one-in-20 chance that the Fund will earn a negative return over a five-year holding period, and virtually no chance of a negative return over a 10-year period. That is the benefit of investment discipline and “staying the course.”

Sincerely,

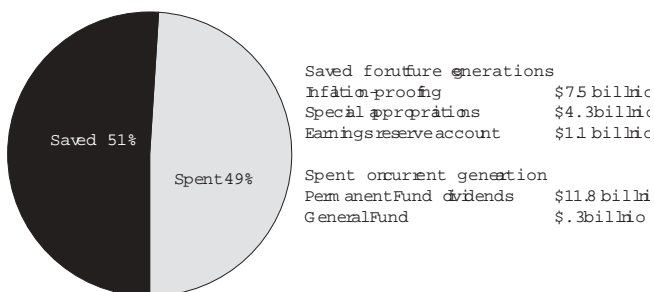
Jim Sampson

Jim Sampson
Chair, Board of Trustees

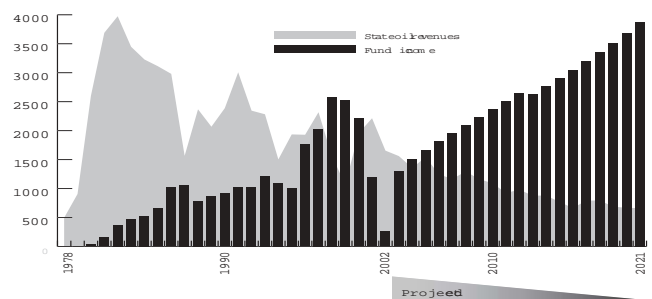
Robert D. Storer

Robert D. Storer
Executive Director

Use of Fund income since inception
\$25 billion of realized income 1976-2002



Comparison of the state's two largest revenue sources
Past and future



Balance sheets

| | June 30 | |
|---|---------------------------------|------------------------------|
| | 2002 | 2001 |
| Assets | | |
| Cash and temporary investments | \$ 614,997,000 | 544,014,000 |
| Receivables, prepaid expenses, and other assets | 355,261,000 | 365,158,000 |
| Investments – | | |
| Marketable debt securities | 9,160,003,000 | 10,005,722,000 |
| Preferred and common stock | 12,052,016,000 | 12,617,711,000 |
| Real estate | 2,540,323,000 | 2,504,466,000 |
| Alaska certificates of deposit | 78,592,000 | 147,423,000 |
| Total investments | <u>23,830,934,000</u> | <u>25,275,322,000</u> |
| Total assets | \$ <u>24,801,192,000</u> | <u>26,184,494,000</u> |
| Liabilities | | |
| Accounts payable | \$ 345,626,000 | 253,160,000 |
| Income distributable to the State of Alaska | <u>930,353,000</u> | <u>1,116,444,000</u> |
| Total liabilities | <u>1,275,979,000</u> | <u>1,369,604,000</u> |
| Fund balances | | |
| Reserved: | | |
| Principal | 21,884,170,000 | 21,047,579,000 |
| Unreserved: | | |
| Unrealized earnings reserve | 505,255,000 | 1,383,576,000 |
| Remaining earnings reserve | <u>1,135,788,000</u> | <u>2,383,735,000</u> |
| Total earnings reserve | <u>1,641,043,000</u> | <u>3,767,311,000</u> |
| Total fund balances | <u>23,525,213,000</u> | <u>24,814,890,000</u> |
| Total liabilities and fund balances | \$ <u>24,801,192,000</u> | <u>26,184,494,000</u> |

Alaska Permanent Fund Corporation Board of Trustees



Board of Trustees: Chair Jim Sampson, Vice Chair Eric E. Wohlforth, Bruce M. Botelho, Wilson L. Condon, Clark S. Gruening, Janie Leask, Executive Director Robert D. Storer

Statements of revenues, expenditures and changes in fund balances

| | Years ended June 30 | |
|--|--------------------------|------------------------|
| | 2002 | 2001 |
| Revenues | | |
| Interest | \$ 576,268,000 | 710,312,000 |
| Dividends | 180,487,000 | 155,551,000 |
| Real estate and other income | <u>227,327,000</u> | <u>225,215,000</u> |
| Total interest, dividends, real estate and other income | <u>984,082,000</u> | <u>1,091,078,000</u> |
| Net increase (decrease) in the fair value of investments - | | |
| Marketable debt securities | 265,704,000 | 359,608,000 |
| Preferred and common stock | (1,876,590,000) | (2,486,857,000) |
| Real estate | 90,947,000 | 119,877,000 |
| Foreign exchange contracts | (41,742,000) | 37,172,000 |
| Currency | (1,298,000) | (5,280,000) |
| Total net decrease in the fair value of investments | <u>(1,562,979,000)</u> | <u>(1,975,480,000)</u> |
| Total revenues | (578,897,000) | (884,402,000) |
| Expenditures | | |
| Operating expenditures | <u>(38,124,000)</u> | <u>(39,490,000)</u> |
| Deficiency of revenues over expenditures | \$ <u>(617,021,000)</u> | <u>(923,892,000)</u> |
| Other financing sources (uses) | | |
| Transfers in | 257,697,000 | 339,315,000 |
| Transfers out | <u>(930,353,000)</u> | <u>(1,116,444,000)</u> |
| Net changes in fund balances | (1,289,677,000) | (1,701,021,000) |
| Fund balances | | |
| Beginning of period | <u>24,814,890,000</u> | <u>26,515,911,000</u> |
| End of period | \$ <u>23,525,213,000</u> | <u>24,814,890,000</u> |